



**COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER**

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February 11, 2010

TO: Supervisor Gloria Molina, Chair
Supervisor Mark Ridley-Thomas
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

FROM:

Wendy L. Watanabe
Auditor-Controller

SUBJECT: **DEPARTMENT OF HEALTH SERVICES' COMMUNITY HEALTH PLAN
FINANCIAL AUDIT FOR YEARS ENDING JUNE 30, 2007 AND 2008**

Attached is the independent auditor's financial audit report for the Department of Health Services' Community Health Plan (CHP) for the years ending June 30, 2007 and 2008. The audit was performed by Simpson & Simpson, Certified Public Accountants (Simpson).

California law requires the CHP and other managed care plans to submit annual financial statements that have been audited by an independent Certified Public Accountant to the State Department of Managed Health Care. The statements must be accompanied by an opinion on the fairness of the financial statement presentation. Simpson's opinion indicates that the financial statements present fairly CHP's financial position and operating results for the years ending June 30, 2007 and 2008. CHP has submitted the report to the Department of Managed Health Care, as required.

Internal Control Findings

In completing the audit of CHP's financial statements, Simpson noted areas where CHP could strengthen internal controls and operating efficiency. Simpson identified control weaknesses related to CHP's eligibility and claims processing system (Patient Management System) billing table, the review and monitoring of pharmacy provider billing costs, and the formalization of the claims dispute process for CHP's In-Home Supportive Services (IHSS) Program. In addition, Simpson reviewed the weaknesses

they identified in the prior internal control report. These weaknesses related to the classification of out-of-plan claims for both CHP's Medi-Cal Program and IHSS Program, the need to replace their outdated Patient Management System, and CHP's ability to handle increased growth.

These issues were discussed with CHP management. The details of Simpson's findings and recommendations and CHP's corrective actions are included in the internal control report, which will be sent to your Board separately.

Please call me if you have any questions, or your staff may contact Jim Schneiderman at (213) 253-0101.

WLW:MMO:JLS:MWM

Attachment

c: William T Fujioka, Chief Executive Officer
John F. Schunhoff, Ph.D., Interim Director, DHS
Andrea Sheridan Ordin, County Counsel
Public Information Office
Audit Committee

**LOS ANGELES COUNTY
DEPARTMENT OF HEALTH SERVICES
COMMUNITY HEALTH PLAN**

**Financial Statements for the
Years Ended June 30, 2008 and 2007
with Independent Auditor's Report**



**LOS ANGELES COUNTY
DEPARTMENT OF HEALTH SERVICES
COMMUNITY HEALTH PLAN
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INDEPENDENT AUDITOR'S REPORT

To the Board of Supervisors of
the County of Los Angeles

We have audited the accompanying balance sheets of the Los Angeles County Department of Health Services Community Health Plan (CHP) as of June 30, 2008 and 2007 and the related statements of income and changes in fund balances, and cash flows for the years then ended. These financial statements are the responsibility of CHP's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of CHP as of June 30, 2008 and 2007 and the results of its operations, changes in its fund balances and its cash flows for the years then ended in conformity with generally accepted accounting principles in the United States of America.

Los Angeles, California
October 26, 2008



**LOS ANGELES COUNTY
DEPARTMENT OF HEALTH SERVICES
COMMUNITY HEALTH PLAN
Balance Sheets
June 30**

ASSETS	2008	2007
Current assets:		
Cash and cash equivalents	\$ 41,864,967	\$ 45,581,770
Receivables (Note 3)	36,461,605	24,500,788
Prepaid expenses	1,398,641	1,289,811
Total current assets	<u>79,725,212</u>	<u>71,372,369</u>
Noncurrent assets:		
Long-term investments	<u>303,504</u>	<u>303,504</u>
Total noncurrent assets	<u>303,504</u>	<u>303,504</u>
TOTAL ASSETS	<u>\$ 80,028,716</u>	<u>\$ 71,675,873</u>
LIABILITIES AND FUND BALANCES		
Current liabilities:		
Accrued capitation	\$ 25,654,482	\$ 30,166,746
Claims payable (Note 4)	12,295,873	10,349,313
Accounts payable	2,628,985	1,384,914
Accrued salaries and related benefits	2,714,089	2,557,670
Amount due to Los Angeles County (Note 5)	7,931,988	7,121,610
Other liability	1,589,652	1,472,887
Total current liabilities	<u>52,815,068</u>	<u>53,053,140</u>
Fund balances:		
Restricted	4,218,702	4,048,877
Unrestricted	22,994,946	14,573,856
Total fund balances	<u>27,213,648</u>	<u>18,622,733</u>
TOTAL LIABILITIES AND FUND BALANCES	<u>\$ 80,028,716</u>	<u>\$ 71,675,873</u>

The accompanying notes are an integral part of these financial statements.

LOS ANGELES COUNTY
DEPARTMENT OF HEALTH SERVICES
COMMUNITY HEALTH PLAN
Statements of Income and Changes in Fund Balance
For the Fiscal Years Ended June 30

	<u>2008</u>	<u>2007</u>
REVENUES		
Capitation premiums	\$ 241,519,824	\$ 224,537,279
OPERATING EXPENSES		
Cost of health care services:		
Capitation premiums	166,610,178	158,174,513
Medical services	6,126,578	5,688,864
Pharmacy	14,320,375	14,222,266
Medical supplies	1,910,203	1,898,540
Total cost of health care services	<u>188,967,334</u>	<u>179,984,183</u>
General and administrative:		
Salaries and employee benefits	15,790,773	14,332,598
Professional and consulting services	7,744,324	5,702,853
Rent	1,158,234	1,056,563
Office expense	5,072,053	4,367,686
Communications	771,848	461,665
Miscellaneous	18,480	149,775
Total general and administrative expenditures	<u>30,555,712</u>	<u>26,071,140</u>
 Total operating expenses	 <u>219,523,046</u>	 <u>206,055,323</u>
 OPERATING INCOME	 21,996,777	 18,481,956
 OTHER REVENUES		
Interest income	1,596,264	2,162,464
Other revenues	3,921,264	
Total other revenues	<u>5,517,528</u>	<u>2,162,464</u>
 Net income	 27,514,305	 20,644,420
 FUND BALANCE, beginning of year	 18,622,733	 24,723,313
 Transfer to LA County (Note 6)	 <u>(18,923,390)</u>	 <u>(26,745,000)</u>
 FUND BALANCE, end of year	 <u>\$ 27,213,648</u>	 <u>\$ 18,622,733</u>

The accompanying notes are integral part of these financial statements.

LOS ANGELES COUNTY
DEPARTMENT OF HEALTH SERVICES
COMMUNITY HEALTH PLAN
Statements of Cash Flows
For the Fiscal Years Ended June 30

	<u>2008</u>	<u>2007</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 27,514,305	\$ 20,644,420
Adjustments to reconcile change in net assets to net cash		
Used by operating activities		
Changes in operating assets and liabilities:		
(Increase)/Decrease in receivables	(11,960,817)	(3,861,273)
(Increase)/decrease in prepaid expense	(108,830)	140,645
Increase/(decrease) in accrued capitation	(4,512,264)	11,820,223
Increase/(decrease) in claims payable	1,946,560	2,109,490
Increase/(decrease) in accounts payable	1,244,071	875,499
Increase/(decrease) accrued salaries and related benefits	156,419	163,426
Increase in amount due to Los Angeles County	810,378	1,565,034
Increase in other liability	116,765	1,393,537
Net cash provided by operating activities	<u>15,206,587</u>	<u>34,851,001</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Transfer to Los Angeles County	<u>(18,923,390)</u>	<u>(26,745,000)</u>
Net cash used by financing activities	<u>(18,923,390)</u>	<u>(26,745,000)</u>
Net increase/(decrease) in cash and cash equivalents	(3,716,803)	8,106,001
Cash and cash equivalents, beginning of the year	<u>45,581,770</u>	<u>37,475,769</u>
Cash and cash equivalents, end of the year	<u><u>\$ 41,864,967</u></u>	<u><u>\$ 45,581,770</u></u>

The accompanying notes are an integral part of these financial statements.

**LOS ANGELES COUNTY
DEPARTMENT OF HEALTH SERVICES
COMMUNITY HEALTH PLAN
Notes to Financial Statements
For the Years Ended June 30, 2008 and 2007**

NOTE 1 – ORGANIZATION AND NATURE OF BUSINESS

The Community Health Plan (CHP) is the Medi-Cal health maintenance organization (HMO) owned and operated by the Los Angeles County Department of Health Services (DHS). It is a federally qualified HMO and is licensed as a prepaid full service health care service plan by the State of California Department of Managed Health Care under the Knox-Keene Health Care Service Plan Act of 1975. CHP provides health care services at low or no cost through the State's Medi-Cal Managed Care and Healthy Families Program, the Los Angeles County's Temporary Employees Program and the Personal Assistance Services Council - Service Employees International Union (PASC-SEIU) Homecare Worker Health Care Plan.

Medi-Cal Managed Care

CHP is one of five Plan Partners contracting with L.A. Care Health Plan, the Local Health Initiative for Medi-Cal Managed Care in Los Angeles County. CHP has over 800 primary care physicians, over 600 pharmacies, including the chain of Rite-Aid stores, and more than a thousand specialists in the Medi-Cal provider network. Under the Medi-Cal program there is no cost to the member for covered services and no co-payments.

Healthy Families Program

CHP contracts with the State Managed Risk Medical Insurance Board (MRMIB) to participate as a Healthy Families Program provider. The Healthy Families Program provides comprehensive health, dental and vision coverage to children in families with incomes at or below 250% of the Federal Income Guidelines. Since the program began in 1998, Community Health Plan has been designated the Community Provider Plan for Los Angeles County for the provision of health coverage.

County's Temporary Employees Program

CHP provides managed health care services to certain long-term (continuously employed for one year or more), full-time, temporary employees of the County of Los Angeles. This coverage excludes physicians and relief nurses receiving special cash compensation in lieu of employee benefits.

PASC-SEIU Homecare Worker Health Care Plan

Effective April 1, 2002, the PASC-SEIU Homecare Worker Health Care Plan was implemented to provide health services to eligible In-Home Supportive Services (IHSS) Workers. The plan provides IHSS Workers access to a provider network comprised of Los Angeles County Department of Health Services facilities and contract providers.

These notes are an integral part of the preceding financial statements.

**LOS ANGELES COUNTY
DEPARTMENT OF HEALTH SERVICES
COMMUNITY HEALTH PLAN
Notes to Financial Statements
For the Years Ended June 30, 2008 and 2007**

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

As a managed health care organization, CHP derives the majority of its revenues from capitation premiums received for providing prepaid health services and prepares its financial statements in accordance with the AICPA Audit and Accounting Guide for "Health Care Organizations." The following is a summary of significant accounting policies used in the preparation of the accompanying consolidated financial statements. Such policies are in accordance with accounting principles generally accepted in the United States of America and have been consistently applied. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses for each reporting period. The significant estimates made in the preparation of CHP's financial statements relate to the assessment of the carrying value of claims payable and contingent liabilities. While management believes that the carrying value of such assets and liabilities is adequate as of June 30, 2008 and 2007, actual results could differ from the estimates upon which the carrying values were based.

Basis of Presentation - Fund Accounting

The accounts of the County are organized on the basis of funds and account groups, each of which is a separate accounting entity. Each fund is accounted for through a separate set of accounts that comprise its assets, liabilities, fund equity, revenues and expenditures or expenses, as appropriate. **CHP, an enterprise activity**, is reported under the general fund of the County of Los Angeles. General fund is used to account for all financial resources except those required to be accounted for in another fund. Resources or expenditures not restricted for a particular purpose are accounted for in the general fund.

Accounting Standards

Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting, CHP has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989.

Concentration of Source of Revenues

CHP received approximately 59% of its premium revenues under service agreements with L.A. Care Health Plan for both fiscal years ended June 30, 2008 and 2007.

These notes are an integral part of the preceding financial statements.

**LOS ANGELES COUNTY
DEPARTMENT OF HEALTH SERVICES
COMMUNITY HEALTH PLAN
Notes to Financial Statements
For the Years Ended June 30, 2008 and 2007**

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash and Cash Equivalents

Cash and cash equivalents consist of CHP's equity portion of the Los Angeles County cash and investment pool. Funds received by CHP are deposited into the cash and investment pool for which the County Treasury is the depository. Funds deposited in the pool are similar in nature to demand deposits, (i.e., funds may be deposited and withdrawn at any time without prior notice or penalty). Interest earned on the pooled funds is accrued in a pooled interest apportionment fund and is allocated based on the average daily cash balances of the fund. The average annual interest rates earned on CHP's deposits during fiscal years ended June 30, 2008 and 2007 were approximately 4.6% and 5.2%, respectively. As of June 30, 2008 and 2007, substantially all investments in the County investment pool were U.S. government securities, bankers' acceptances and negotiable certificates of deposit.

Long-Term Investments

Long-term investments consist of restricted investments on deposit with the California Department of Managed Health Care (DMHC). These investments consist of U.S. Treasury securities, and due to their restricted nature, are classified as long-term without regard to contractual maturity. Market values approximate carrying values as of June 30, 2008 and 2007.

Claims Reimbursement Receivable

Claims reimbursement receivable are claims for capitated services paid by CHP that are reimbursable from the contracted medical groups and hospitals. Management believes that uncollectible amounts, if any, will not be material to the financial statements.

Accrued Capitation

CHP pays capitation premiums to the contracted medical groups and hospitals in arrears on a per member per month basis. Accrued capitation consists of capitation payments due the contracted medical groups and hospitals.

Claims Payable

The liability for claims payable includes adjudicated claims, claims pending adjudication and a provision for incurred but not reported claims. The amount payable for the claims pending adjudication is reduced by an allowance for denied claims estimated based on paid/denied ratio of claims closed during the year. The provision for incurred but not reported claims is estimated using a lag study based upon historical data including the period between the date services are rendered and the date claims are received and paid and denied claim activity. The estimate for incurred but not reported claims is made on an accrual basis and adjusted in future periods as required.

These notes are an integral part of the preceding financial statements.

**LOS ANGELES COUNTY
DEPARTMENT OF HEALTH SERVICES
COMMUNITY HEALTH PLAN
Notes to Financial Statements
For the Years Ended June 30, 2008 and 2007**

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Any adjustments to the prior period estimates are included in the current period. Such estimates are subject to the impact of changes in the regulatory environment and economic conditions. Given the inherent variability of such estimates, the actual liability could differ significantly from the amounts provided. While the ultimate amount of claims and losses paid are dependent on future developments, management is of the opinion that the recorded reserves are adequate to cover such costs. These liabilities are reduced by estimated amounts recoverable from contracted health care providers.

Fund Balance

Fund balances are reported as restricted when constraints placed on its use are either: (1) externally imposed by creditors, grantors, contributors or laws or regulations of other governments, or (2) imposed by law through constitutional provisions or enabling legislation. CHP's restricted fund balance consists of the amounts required to satisfy the deposit and tangible net equity requirements of the Department of Managed Health Care as of June 30, 2008 and 2007 (see Note 6).

Premium Revenues

CHP's premium revenues are capitation payments received for plan enrollees on a per member per month basis. Premiums are recognized as revenue in the month in which the members are entitled to service.

Cost of Health Care Services

CHP contracts with various medical groups to provide professional care to its members on a capitated, or fixed per member per month fee basis. Capitation contracts generally include a provision for stop-loss and non-capitated services for which CHP is liable. Additionally, CHP contracts with certain hospitals to provide hospital care to enrolled members on a capitation basis.

The cost of health care services is recognized in the period in which services are provided and includes an estimate of the cost of services which have been incurred but not yet reported. Such costs include capitation payments to contracted medical groups and hospitals for primary care, specialty and hospital services and the cost of non-capitated medical services, pharmacy and medical supplies.

Fair Value of Financial Instruments

The estimated fair value amounts of cash equivalents and long-term investments approximate their carrying amounts in the financial statements and have been determined by CHP using available market information and appropriate valuation methodologies. The carrying amounts of cash equivalents approximate fair value due to the similarity in its nature to demand deposits. The fair values of long-term investments are estimated based on quoted market prices and dealer quotes for similar investments.

These notes are an integral part of the preceding financial statements.

**LOS ANGELES COUNTY
DEPARTMENT OF HEALTH SERVICES
COMMUNITY HEALTH PLAN
Notes to Financial Statements
For the Years Ended June 30, 2008 and 2007**

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Tax

As an operating division of the County, CHP is exempt from State and Federal income taxes.

NOTE 3 – RECEIVABLES

Receivables are comprised of interest receivable, capitation premiums receivable and claims reimbursement receivable from health care service providers. As of June 30, 2008 and 2007, receivables consisted of the following:

	2008		2007
Capitation premiums receivable	\$ 20,735,652	\$	13,084,321
Claims reimbursement receivable	14,906,216		10,819,588
Interest receivable	259,645		596,879
Other receivable	560,092		
	<u>\$ 36,461,605</u>	\$	<u>24,500,788</u>

NOTE 4 – CLAIMS PAYABLE

Claims payable are comprised of claims payable, claims pending adjudication and a liability for claims incurred but not yet received, reduced by management's estimate of the amount that will be denied and the amount that will be recoverable from contracted providers. As of June 30, 2008 and 2007, claims payable consisted of the following:

	2008		2007
Claims payable/pending adjudication	\$ 27,965,949	\$	19,725,835
Claims incurred but not received	9,804,409		7,596,607
Claims payable	52,034		42,377
Less: Allowance for denied claims	(25,526,519)		(17,015,506)
	<u>\$ 12,295,873</u>	\$	<u>10,349,313</u>

NOTE 5 – AMOUNT DUE TO LOS ANGELES COUNTY

Cash disbursements for CHP are made from the general fund of Los Angeles County Department of Health Services (DHS). CHP transfers funds periodically to the general fund from its County cash and investment pool to reimburse the general fund or to fund its projected cash disbursements. The amount due to Los Angeles County consists of the amount owed to the DHS general fund and the amount due other County funds for services such as telephone, rent and information system support. As of June 30, 2008 and 2007, the amount due to Los Angeles County consisted of the following:

These notes are an integral part of the preceding financial statements.

**LOS ANGELES COUNTY
DEPARTMENT OF HEALTH SERVICES
COMMUNITY HEALTH PLAN
Notes to Financial Statements
For the Years Ended June 30, 2008 and 2007**

NOTE 5 – AMOUNT DUE TO LOS ANGELES COUNTY (Continued)

	<u>2008</u>	<u>2007</u>
Amount due to Los Angeles County funds	<u>\$7,931,988</u>	<u>\$7,121,610</u>

NOTE 6 – TRANSFER TO LOS ANGELES COUNTY

CHP transfers fund in excess of 300% of the total net equity to the general fund of DHS. During the fiscal years ended June 30, 2008 and 2007, the total transfer to DHS amounted to \$18,923,390 and \$26,745,000, respectively.

NOTE 7 – RETIREMENT PLAN

The County's retirement plan covers CHP employees and provides for monthly pension payments to eligible employees upon retirement. Salaries and employee benefits expense includes a provision for the retirement plan cost, as well as vacation and sick pay, which is estimated based on a percentage of salaries expense. The actual cost of the retirement plan, actuarial present value of accumulated retirement plan benefits, and net assets available for retirement plan benefits are not separately identifiable for CHP.

NOTE 8 – REGULATORY REQUIREMENTS

CHP, as a California licensed health service plan, is regulated by the State of California Department of Managed Health Care (DMHC). Title 28 of the Code of California Regulations requires that CHP maintain certain deposits assigned to the Director of the DMHC and comply with certain minimal capital or tangible net equity requirements. Management believes that as of June 30, 2008 and 2007, CHP met its regulatory requirements.

NOTE 9 – CONTINGENCIES

The County has agreed to fund CHP losses, if any, and to cover CHP under its self-insured medical malpractice program when medical services are provided at a County facility. In addition, the County has agreed to cover CHP under its self-insured workers' compensation program. These coverages are provided to CHP at no cost.

NOTE 10 – SUBSEQUENT EVENT

In August 2008, CHP recorded an operating transfer-out of \$12,468,000 to the Los Angeles County Department of Health Services general fund.

These notes are an integral part of the preceding financial statements.